Supreme Court, U. S.
FILED
JUN 5 1978
MICHAEL RODAK, JR., CLERK

IN THE

Supreme Court of the United States

OCTOBER TERM, 1977

No. 77-1645

TRANSAMERICA MORTGAGE ADVISORS, INC. (TAMA); KENT L. COLWELL; J. WENDELL COOMBS; JOHN R. JENSEN; RALPH D. WENGER; JOHN HAVENS; TRANSAMERICA CORPORATION; TRANSAMERICA LAND CAPITAL, INC.; and MORTGAGE TRUST OF AMERICA,

Petitioners,

VS.

HARRY LEWIS,

Respondent.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

BRIEF FOR RESPONDENT IN OPPOSITION TO PETITION FOR WRIT OF CERTIORARI

DONALD N. RUBY
Attorney for Respondent
845 Third Avenue
New York, New York 10022

Of Counsel

ERIC L. KEISMAN
WOLF POPPER ROSS WOLF & JONES

TABLE OF CONTENTS

	PAGE
Opinions Below	1
Jurisdiction	2
Question Presented	2
Statutes	2
Statement of the Case	3
Reasons for Denying the Writ	6
Conclusion	12

Table of Authorities

Cases:

Abrahamson v. *Fleschner*, 568 F.2d 862 (2d Cir. 1977), *petition for cert. filed*, Dkt. No. 77-1279 ..... 1, 2, 6, 7, 8, 11, 12

Blue Chip Stamps v. *Manor Drug Stores*, 421 U.S. 723 (1975) 7, 8

Cort v. *Ash*, 422 U.S. 66 (1975) 8, 10

Palmer v. *Massachusetts*, 308 U.S. 79 (1939) 11

SEC v. *Capital Gains Research Bureau, Inc.*, 375 U.S. 180 (1963) 10

Wilson v. *First Houston Investment Corp.*, 566 F.2d 1235 (5th Cir. 1978) 1, 6, 11

PAGE

Statutes and Rules:

Internal Revenue Code of 1954, as amended, 26 U.S.C. § 1 *et seq.* 3

Sections 856-858 (26 U.S.C. § 856-858) 3

Investment Advisers Act of 1940,

15 U.S.C. § 80b-1, *et seq.* 9
15 U.S.C. § 80b-6 (Section 206) 2, 4, 9
15 U.S.C. § 80b-14 (Section 214) 2, 4, 9
15 U.S.C. § 80b-15 (Section 215) 9

Investment Company Act of 1940, 15 U.S.C. § 80a-1 *et seq.* 11

Securities Exchange Act of 1934, 15 U.S.C. § 78a *et seq.*,

Section 10(b), 15 U.S.C. § 78j(b) 8

Rule 10b-5 under the Securities Exchange Act of 1934, 17 C.F.R. § 240.10b-5 8

IN THE

Supreme Court of the United States

OCTOBER TERM, 1977

No. 77-1645

TRANSAMERICA MORTGAGE ADVISORS, INC. (TAMA); KENT L. COLWELL; J. WENDELL COOMBS; JOHN R. JENSEN; RALPH D. WENGER; JOHN HAVENS; TRANSAMERICA CORPORATION; TRANSAMERICA LAND CAPITAL, INC.; and MORTGAGE TRUST OF AMERICA,

Petitioners,

VS.

HARRY LEWIS,

Respondent.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

BRIEF FOR RESPONDENT IN OPPOSITION TO PETITION FOR WRIT OF CERTIORARI

Opinions Below

The opinion of the District Court, incorporated in its Order (*Pet. App.* 6-8), and a further Order of the District Court (*Pet. App.* 10-11), are unreported.

The opinion of the Court of Appeals has not yet been reported officially, or otherwise.

The majority opinion of the Court of Appeals adopts the rationale of the majority opinions in *Abrahamson* v. *Fleschner*, 568 F.2d 862 (2d Cir. 1977), and *Wilson* v. *First Houston Investment Corp.*, 566 F.2d 1235 (5th Cir. 1978), in each of which cases the Court of Appeals recognized

an implied private right of action arising under the anti-fraud provisions of the Investment Advisers Act of 1940 ("Advisers Act"). The dissenting opinion relies upon the analysis presented by the dissenting opinion in *Abrahamson* v. *Fleschner, supra.*

The petition for certiorari that was filed in the *Abrahamson* case was denied by this Court, *sub nom. Malcolm K. Fleschner, et al.* v. *Robert Abrahamson et ux,* No. 77-1279, on May 15, 1978.

Jurisdiction

The jurisdictional requisites are adequately set forth in the Petition at page 2.

Question Presented

Did the Court of Appeals correctly hold that a private cause of action may properly be implied under the Advisers Act in favor of appropriate plaintiffs, such implication being necessary to achieve the goals of Congress in enacting that statute; and thus correctly determine that the District Court had erred in dismissing the complaint in a shareholders' derivative and representative action brought under that statute on the grounds that the federal courts lacked subject matter jurisdiction over the claims asserted?

Statutes

The pertinent provisions of the Investment Advisers Act of 1940, Section 206 (54 Stat. 852, as amended, 74 Stat. 887, 15 U.S.C. § 80b-6) and Section 214 (54 Stat. 856, 15 U.S.C. § 80b-14), are set forth in Petitioner's Appendix, at pages 77-78.

Statement of the Case

Respondent Harry Lewis brought this suit in the United States District Court for the Southern District of New York in April 1973, as a shareholder of the petitioner Mortgage Trust of America ("MTA"), derivatively on behalf of MTA and representatively on behalf of all similarly situated shareholders of MTA. MTA is a real estate investment trust, within the meaning of Sections 856-858 of the Internal Revenue Code of 1954, as amended; and its shares of beneficial interest are and were at the time when the action was instituted listed and traded on the New York Stock Exchange. Petitioner Transamerica Mortgage Advisors, Inc. ("TAMA"), a third-tier subsidiary of petitioner Transamerica Corporation, is the investment adviser of MTA, pursuant to an investment advisory agreement; and advises MTA on its real estate investments as well as administering its day-to-day operations. TAMA was and is the sole investment adviser of MTA, which is in turn TAMA's sole client. Petitioner Transamerica Corporation is the parent of TAMA and the sponsor of MTA. Petitioner Transamerica Land Capital, Inc. ("TALC"), is a first-tier subsidiary of Transamerica Corporation. MTA purchased its original investment portfolio of mortgages from TALC, and MTA's original officers and employees had previously been associated with TALC. The individual defendants, not all of whom are petitioners here, were trustees of MTA; several of whom had also been affiliated with Transamerica Corp., TAMA or other subsidiaries of Transamerica Corp.

The Complaint set forth six causes of action; the first three being stated as derivative causes, and the latter three being restatements of the first three, set in representative form.

The first and fourth causes of action sought equitable relief and damages for the harm alleged to have arisen from fraudulent and unfair conduct involved in the making and subsequent performance of the investment advisory agreement between MTA and TAMA. Transamerica Corporation allegedly controlled and directed the formation of both MTA and TAMA and the formulation and performance of this contractual relationship. In essence, these causes of action asserted that, in consequence of the domination and control exercised over MTA by Transamerica, TAMA, *et al.*, the former entered into essentially a contract of adhesion with TAMA; under which it was required to pay, and did pay, advisory fees that were grossly excessive to the point of fraudulence and that were computed on bases that encouraged fraud and overreaching by TAMA and others so as to maximize such fees.

The second and fifth causes of action claim fraudulent conduct as well as unfairness in respect of the transactions by which MTA, at the commencement of its operation as a real estate investment trust, was caused by petitioners Transamerica, TAMA and TALC to acquire its original investment portfolio from the latter.

The third and sixth causes of action alleged, in essence, that because of the control exercised by Transamerica Corporation and its affiliates, including TAMA, and because of the inherent conflicts of interest between those petitioners and MTA, MTA did not receive the investment advice to which it was entitled from TAMA. It is asserted that Transamerica and its affiliates had been allowed to retain the best investment opportunities, within the range of MTA's investment potentialities, which had come to the attention of TAMA.

Jurisdiction over each of these causes of action was based on the Advisers Act, including particularly Sections 206 and 214 thereof.

In March 1974, shortly after the case was transferred, by stipulation of the parties, to the Northern District of California, petitioners (and the other defendants below) moved for dismissal of the Complaint, pursuant to Rules 12(b)(6) and 56 of the Federal Rules of Civil Procedure. While a variety of grounds for the relief sought were advanced, the District Court reached only one of them. In a brief order, it determined that "since Section 206 of the Investment Advisers Act of 1940 affords no private right of action, and that consequently the Court has no jurisdiction of the plaintiff's claims, the defendants' motion to dismiss is granted." (*Pet. App.* 7; emphasis omitted.)

Petitioners' additional motions for summary judgment and for a more definite statement were denied as "moot." While the order of the District Court granted respondent leave to amend, he declined to do so; and an order dismissing the action with prejudice was entered on November 21, 1974.

Respondent appealed to the Court of Appeals.

On April 19, 1978, the Court of Appeals reversed, the majority explicitly adopting "the rationale of the majorities in *Abrahamson* and *Wilson*." (*Pet. App.* 4.)

The Court specifically refused to consider the additional issues that had been raised in the District Court by petitioners, since that Court had not determined them, but had dismissed on the basis of a "naked holding of a lack of jurisdiction. . . ." (*Pet. App.* 3.) The Court of Appeals held only that:

> "Accordingly, we hold that the implication of a private right of action for injunctive relief and damages under the Advisers Act in favor of appropriate plaintiffs is necessary to achieve the goals of Congress in enacting the legislation. The District Court holds subject matter

jurisdiction to entertain such actions and pendens state claims pursuant to 28 U.S.C. § 1331." (*Pet. App.* 4-5.)

The dissenting Judge, in a single paragraph opinion, conceded that "reasonable minds may differ" upon the issue presented; and dissented on the basis of the dissenting opinion in the *Abrahamson* case (*Pet. App.* 5.)

Reasons for Denying the Writ

The Petition for Certiorari here specifically, and almost entirely, relies upon the reasoning of the petition for certiorari in *Fleschner* v. *Abrahamson*, Dkt. No. 77-1279; which petition was denied by this Court on May 15, 1978. This case, presenting the same central question of law, similarly presents no greater reason for review by this Court than was present in the *Abrahamson* case. If anything, this case is far less appropriate for a grant of *certiorari*, in that it reaches this Court upon an extremely limited and undeveloped record; that is, upon a terse order of the District Court dismissing for want of subject matter jurisdiction, and a brief opinion of the Court of Appeals, vacating that dismissal in reliance upon the analysis of the majorities in *Abrahamson* and in *Wilson* v. *First Houston Investment Corp., supra*. The reasons for denying for writ here are, we respectfully submit, ably and forcefully set forth in the Brief for Respondents in Opposition to Certiorari in *Abrahamson*, particularly at pages 8 through 18; and, rather than repeating them at length, we respectfully ask that the Court refer thereto.

In addition, we submit that the additional arguments raised by petitioners here add nothing of significance to the arguments made, and disposed of, by this Court, with respect to the *Abrahamson* case.

(1) Each of the three Courts of Appeals that have had occasion to consider the issue has determined that it is appropriate to imply a private right of action under the antifraud provisions of the Advisers Act. Essentially, in so determining, the Courts of Appeals for the Fifth and the Ninth Circuits have followed the studious and reasoned analysis of the majority of the Second Circuit in the *Abrahamson* case. The mere fact that, in each case, there was a dissenting opinion, creates no basis for the grant of *certiorari* here. Petitioners' argument that the implication of the private right of action so recognized "scuttles the limitations on securities law actions," which this Court established in *Blue Chip Stamps* v. *Manor Drug Stores*, 421 U.S. 723 (1975), is aptly and dispositively answered by the opinion of Judge Timbers in *Abrahamson*, where he states:

> "The *Blue Chip* decision was based on the *express language* of Section 10(b) and Rule 10b-5 requiring a fraud 'in connection with the purchase or sale of any security.' *Neither Section 206 of the Advisers Act nor Rule 206(4)-1 contains any such requirement.* While the Court stated in *Blue Chip* that the purchaser-seller limitation under Section 10(b) protected against vexatious and speculative claims, it did not say or suggest that *any* claim would be too speculative for recovery under the other securities acts unless the plaintiff was a purchaser or seller. Indeed the Court acknowledged that provisions of the other securities acts afford rights of action to persons who are not purchasers or sellers. 421 U.S. at 733-34." (568 F.2d at 877; emphasis in original; footnote omitted.)

Moreover, implication of a private right of action under the antifraud provision of the Advisers Act does not create the limitless class of plaintiffs that this Court saw as poten-

tially arising should persons who had neither purchased nor sold securities been permitted to bring actions under Section 10(b) or Rule 10b-5 of the Securities Exchange Act of 1934. In the context of the Advisers Act, it must be plain that a remedy under Section 206 would arise only where there was, or had been, an actual advisory relationship; whereas, in the context of *Blue Chip*, a suit could have been based, absent the purchaser-seller requirement, on the absence of any relationship or transaction.

In addition, each of the Courts of Appeals that have found the implied right of action under the Advisers Act to exist has adhered to the four-element test laid down by this Court in *Cort* v. *Ash*, 422 U.S. 66, 78 (1975), for determining whether a private remedy should be implied pursuant to a statute that does not expressly provide such a remedy. Particularly inasmuch as *Cort* v. *Ash* was decided subsequent to the *Blue Chip* case, a careful adherence to the standards suggested in the *Cort* case cannot and should not be taken as an evasion of the mandate of *Blue Chip*.

Nothing is added to petitioners' argument by their claim for special attention to the argument, made by petitioners in *Abrahamson*, that it is important that Congress has not provided an express private remedy under the Advisers Act. No negative implication can be drawn concerning the intention of the Legislature from such inaction. Congress has surely been aware of the developing law of implied private remedies under the general antifraud provisions of the federal securities laws. Given such awareness, its inaction is far too slender a reed upon which to build an edifice of negative intention.

Petitioners' plaint that the Second, Fifth and Ninth Circuits have "uncovered an unspoken private legal right" is simply a diffuse protest against the entire doctrine that

implied civil remedies may be derived from statutes creating substantive law. We submit that this proposition is too well settled to warrant further discussion here.

(2) Petitioners' argument that implication of a private right of action under the Advisers Act unnecessarily and improperly brings into the federal courts claims that are inherently and traditionally state law claims is wholly insupportable. Congress, in enacting that statute, explicitly declared its finding that "investment advisers are of national concern," noting, *inter alia*, that both their advisory function and the transactions by which they entered into agreements involved "means and instrumentalities of interstate commerce"; that their advisory functions "customarily relate to the purchase and sale of securities traded on national securities exchanges . . ."; and that "the foregoing transactions" substantially affected interstate commerce and national securities exchanges as well as other securities markets. (Investment Advisers Act, § 201 (15 U.S.C. § 80b-1).) By virtue of Section 214 of the Advisers Act, the federal district courts are given "jurisdiction of violations of this subchapter or the rules, regulations or orders thereunder. . . ." (15 U.S.C. §80b-14.) Section 215 of the Act declares void "every contract made in violation of any provision of this subchapter. . . ." (15 U.S.C. § 80b-15(b).) Section 206 of the Act makes it a violation of federal law for an investment adviser to "defraud," to engage in any "transaction, practice or course of business which operates as a fraud or deceit," or "to engage in any act, practice or course of business which is fraudulent, deceptive or manipulative." (15 U.S.C. § 80b-6(1), (2), (4).) It is altogether too clear that Congress had determined that the relationship of investment adviser and advisee, and the conduct of investment advisers toward clients, prospective clients and the investing public, was in fact a matter of federal regulatory concern. This was clearly

recognized by this Court in *SEC* v. *Capital Gains Research Bureau, Inc.*, 375 U.S. 180 (1963); and most cogently and irrefutably elucidated in the *Abrahamson* case. (See *Pet. App.* 29-31.)

Since fraud and other violations of the Advisers Act are clearly a matter of federal concern, and within the jurisdiction of the federal courts, petitioners' effort to raise the shibboleth of "undue burden" on the federal courts is an invitation to the judiciary to ignore its responsibilities under the Act. Given the obvious federal concern, the suggestion that the federal courts should avoid adjudication of these matters in order to reduce their workload, whatever the merits of the claims that have been, or may be, asserted, is unworthy of serious consideration. Petitioners purport to see a real burden upon the federal courts, especially in actions brought by shareholders of real estate investment trusts, against those trusts "and" their advisers. In support of this argument, they point to a total of twelve such actions, brought since 1973. (*Pet. for Cert.* 6.) Thus, petitioners argue that the commencement of approximately two actions per year over a six-year span, challenging the investment advisory contracts under which real estate investment trusts have operated, imposes an insupportable burden upon the federal courts. We respectfully submit that this suggestion is unworthy of serious consideration.

(3) Petitioners' final point to which they "urge special attention" is no more than a tired rehash of a settled issue. Surely, where, as in the cases upholding the existence of a private right of action under the Advisers Act, the courts have carefully followed and applied the criteria set down by this Court in *Cort* v. *Ash, supra*, there is no "classic confrontation" with the "express words of a statute." (See *Pet. for Cert.* 7.) As was cogently pointed out in the

Brief for Respondents in Opposition in the *Abrahamson* case:

> "That argument would lead to the illogical conclusion that no *implied* rights exist unless *express* rights are first granted. The law is otherwise. The doctrine of implied private rights of action arose precisely *because* statutes obviously designed to protect certain classes of persons omitted to provide those persons with express private remedies. See, e.g., *Texas & Pacific R.R. Co.* v. *Rigsby*, 241 U.S. 33 (1916)." (At 14; emphasis in original.)

We submit that, so long as the recognition of implied private rights of action occurs in a manner consistent with this Court's prior rulings, the concern expressed by Mr. Justice Frankfurter in *Palmer* v. *Massachusetts*, 308 U.S. 79, 83 (1939) (cited in Petition for Writ of Certiorari, at 7), is fully vindicated.

Finally, we submit that the decision of the Court of Appeals in this case, following, as it does, the rulings and rationale of the *Abrahamson* case and the *Wilson* case, is wholly consistent not only with the purposes of the Advisers Act and the prior rulings of this Court, but is consistent with the long line of decisions recognizing such private rights of action under the Investment Company Act, as well as under the antifraud and other provisions of the Exchange Act. It is, as respondents point out in their brief in *Abrahamson*, "the reasoned and inevitable product of more than forty years' experience with the federal securities laws." (At 8.)

In the present case, the Court of Appeals for the Ninth Circuit has held no more than that a private right of action may be implied, for the benefit of a proper plaintiff, under

the Investment Advisers Act of 1940. No other issue is presently before this Court, nor is any other issue proffered directly or indirectly by petitioners ripe for review. *A fortiori,* no issue is presented by the instant Petition that was not presented and considered in the *Abrahamson* case. There is nothing new, or novel, in the record of this case to date, or in the decision of the Court of Appeals, giving rise to any reason for review by this Court.

CONCLUSION

For the foregoing reasons, and for the reasons stated in the Brief for Respondents in Opposition in *Fleschner* v. *Abrahamson,* Dkt. No. 77-1279, the Petition for a Writ of Certiorari to the United States Court of Appeals for the Ninth Circuit should be denied.

Respectfully submitted,

DONALD N. RUBY
Attorney for Respondent
845 Third Avenue
New York, New York 10022

Of Counsel

ERIC L. KEISMAN
WOLF POPPER ROSS WOLF & JONES